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In the Supreme Court of the United States

OCTOBER TERM, 1943

No. 126

THOMAS P. NICHOLS & SON COMPANY, PETITIONER

v.

THE NATIONAL CITY BANK OF LYNN AND FEDERAL DEPOSIT INSURANCE CORPORATION

ON PETITION FOR A WRIT OF CERTIORARI TO THE SUPERIOR COURT OF ESSEX COUNTY, COMMONWEALTH OF MASSACHUSETTS

BRIEF FOR THE FEDERAL DEPOSIT INSURANCE CORPORATION IN OPPOSITION

OPINIONS BELOW

The findings, rulings, order for decree, and decree of the Superior Court of Essex County, Commonwealth of Massachusetts (R. 32–36, 40), are not reported. The opinion of the Supreme Judicial Court of Massachusetts (R. 56–64) is reported in 48 N. E. (2d) 49.

JURISDICTION

The judgment of the Supreme Judicial Court was entered on March 30, 1943 (R. 65). The petition for a writ of certiorari was filed June 29, 1943. The jurisdiction of this Court is invoked under Section 237 (b) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Pursuant to a general plan for the liquidation of the National City Bank of Lynn, the Essex Trust Company assumed all deposit liabilities of the Bank and received certain of its liquid assets. The remaining assets were pledged to the Federal Deposit Insurance Corporation for a loan, the proceeds of which were turned over to the Essex Trust Company. Subsequent to these transactions, petitioner obtained a judgment against the Bank and execution was returned unsatisfied. Petitioner thereupon brought suit against the Bank and the Corporation to recover on its judgment. The case presents the following question:

Whether the contract between the Federal Deposit Insurance Corporation and the Bank should be reformed so as to require the Federal Deposit Insurance Corporation to pay petitioner the amount due it under its judgment against the Bank.

STATUTE INVOLVED

Section 12 B (n) (4) of the Federal Reserve Act, as amended, c. 614, 49 Stat. 684, 699 (12 U. S. C. 264 (n) (4)) provides:

> Whenever in the judgment of the board of directors such action will reduce the risk or avert a threatened loss to the Corporation and will facilitate a merger or consolidation of an insured bank with another insured bank, or will facilitate the sale of the assets of an open or closed insured bank to and assumption of its liabilities by another insured bank, the Corporation may, upon such terms and conditions as it may determine, make loans secured in whole or in part by assets of an open or closed insured bank, which loans may be in subordination to the rights of depositors and other creditors, or the Corporation may purchase any such assets or may guarantee any other insured bank against loss by reason of assuming the liabilities and purchasing the assets of an open or closed insured bank. Any insured national bank or District bank, or, with the approval of the Comptroller of the Currency, any receiver thereof, is authorized to contract for such sales or loans and to pledge any assets of the bank to secure such loans.

STATEMENT

During the year 1938, negotiations were in progress between representatives of the National

City Bank of Lynn, Massachusetts, herein referred to as the Bank, and the Federal Deposit Insurance Corporation relative to the proposed voluntary liquidation of the Bank (R. 33). In accordance with the plan eventually adopted and put into effect on December 3, 1938 (R. 32), the deposit liabilities of the Bank were assumed by the Essex Trust Company which received in consideration therefor certain assets of the Bank as well as the proceeds of a cash loan amounting to approximately $1,300,000 made by the Corporation to the Bank (and transferred by the latter to the Essex Trust Company) upon the security of those assets of the Bank not turned over to the Essex Trust Company (R. 32, 33).

On January 8, 1940, a judgment in the sum of $42,102.02, together with costs, was obtained by petitioner against the Bank in a suit commenced on November 2, 1936 (R. 32).[1] Execution upon petitioner's judgment against the Bank having been returned unsatisfied (R. 32), it brought the instant suit against the directors of the Bank, the Essex Trust Company, the Bank, and the Corporation. Demurrers were sustained to the action against the directors (R. 26), and it appears that petitioner discontinued its action against the Essex Trust Company (R. 57). Initially, petitioner's bill of complaint averred that the Bank was in-

[1] The exact nature of the action brought by petitioner does not appear from the record. It was not, however, based upon a deposit obligation and was described by the courts below as one sounding in contract or tort (R. 32, 56).

solvent at the time the loan contract was negotiated (R. 2) and that the pledge of the Bank's collateral to the Corporation was in fraud of creditors (R. 3). During the course of the trial, however (R. 34), and subsequently by formal amendment to the complaint (R. 37), petitioner abandoned its contention that the Bank was insolvent and elected to proceed upon the theory that the loan agreement and the pledge of assets thereunder were for its benefit and were intended to provide for the payment of its claim as a creditor. The Superior Court dismissed the bill of complaint as to the Federal Deposit Insurance Corporation (R. 36, 40), finding that the Bank was solvent at the time that the loan was made (R. 32); that the loan agreement was valid, having been entered into for a fair consideration without fraud or bad faith (R. 35); and that the agreement neither expressly nor impliedly contemplated that the petitioner's claim be paid by the Corporation. The court further held that the Bank held an equity of redemption in the assets pledged to the Corporation, the book value of which exceeded the amount of the loan by more than $500,000 (R. 36). It entered judgment directing the Bank to pay petitioner the sum of $42,136.57, with interest, and restrained the Bank and its liquidating agent, until petitioner's judgment was satisfied, from selling, assigning, or otherwise disposing of any property, including the equity of redemption in the assets pledged to the Corporation, except

such transfers and conveyances as were required to be made to the Corporation pursuant to the provisions of the agreement (R. 40). On appeal, the Supreme Judicial Court of Massachusetts affirmed (R. 65) and on rescript from the Supreme Judicial Court, the Superior Court of Essex County reentered its decree of August 27, 1942 (R. 65–66).

ARGUMENT

It is clear from the record in this case that the sole relief which petitioner seeks is the immediate payment by the Corporation of its judgment claim against the Bank. The record discloses that the Bank is solvent and that the book value of the assets which have been pledged to the Corporation by the Bank exceed by $500,000 the face amount of the loan.[2] Petitioner has obtained a decree in the instant case directing the Bank to pay the judgment as soon as the lien of the Corporation has been satisfied. Consequently, petitioner's contention that it is being deprived of its property without due process of law in contravention of the Fourteenth Amendment (Pet. 5,

[2] The record contains no evidence as to the appraised or liquidating value of the Bank's assets pledged to the Corporation as security for the loan, since this question ceased to be an issue when petitioner abandoned the theory of insolvency and proceeded upon the theory that the Bank was solvent. Petitioner amended its bill of complaint by withdrawing its allegation that the Bank was insolvent and substituting an allegation that the Bank was solvent (R. 37); it apparently introduced no evidence to show that the book value of the assets pledged to the Corporation was other than their true value.

16–17) and its suggestions that other creditors are to be paid in full and that it will receive nothing (Pet. 3, 6, 12–13) find no support in the record and call for no discussion on the part of respondent Corporation.

The gist of petitioner's argument seems to be that it was the intent of the Bank and the Corporation to make provision for the payment of petitioner's claim, that such provision was omitted by inadvertence and mistake, and that the loan contract accordingly should be reformed so as to provide therefor.[3] In the alternative, it appears to urge that if there were no intent to make provision for such payment, such action on the part of the Corporation was in violation of the policy evidenced by both the Federal Reserve Act and the National Bank Act of 1864 and that it should therefore be allowed to recover against the

[3] It is clear from the record that the transactions which contemplated the liquidation of the Bank involved a third party, namely, the Essex Trust Company (R. 32). The arrangements between the Bank and the Essex Trust Company disclosed the persons who were to be paid in the course of the liquidation proceedings (R. 42, 44–45). The Essex Trust Company assumed the obligation to make such payments and received, in addition to other assets, the proceeds of the loan with which to do so (R. 32). The Corporation agreed to pay no one (R. 60, 61). Hence, if any reformation were to be made, it would have to be made in the arrangements entered into with the Essex Trust Company, and the voluntary discontinuance (R. 57) of petitioner's action against the Trust Company would seem to have resulted in the absence of a necessary party.

Corporation. We submit that these contentions are without merit.

1. The record discloses that the Bank submitted to the Corporation as part of its loan application a schedule of liabilities and a list of creditors which did not include petitioner (R. 34). But the Massachusetts courts both found that there was no intention to defraud the petitioner or any other person since the failure to include petitioner's name as a creditor was apparently due to the fact that the Bank, relying upon advice of counsel, considered petitioner's claim as "dead" and no longer pending (R. 34). Neither the Corporation nor the Essex Trust Company assumed the obligation to pay any creditor of the Bank whose name was not listed in the Bank's schedule of liabilities. Presumably, all known creditors of the Bank, other than depositors, whose claims were certain in amount, were paid before any transfer of assets was made (see R. 33, 35). The Essex Trust Company assumed all listed deposit liabilities, and a special fund of $10,000 was placed on deposit there for the payment of certain claims such as counsel fees, utility bills and secretarial services, which were anticipated but which were uncertain in amount. This fund was not one which was intended to take care of petitioner's claim. (R. 35.) The provisions of the loan agreement between the Federal Deposit Insurance Corporation and the Bank conclusively established that it was intended

for the benefit only of the deposit liabilities (R. 50–56).

In view of the warranties of the Bank as evidenced by the schedule submitted to the Corporation in support of the loan application, the Corporation had a right to rely upon the accuracy of the obligations as represented by the Bank and to make the loan in the sum that it did.[4] Moreover, there is nothing in the record to justify a court in assuming that had the facts been otherwise than as disclosed by the loan application, the Corporation, in the exercise of its discretion, nevertheless would have made the loan in an amount sufficiently large to include petitioner's claim of $100,000.[5] In these circumstances, we submit, no court would be at liberty to draw an inference that provision for the payment of petitioner's claim was omitted from the loan agreement through inadvertence.

The courts below also found that petitioner's claim, which is not a deposit claim, and which did not ripen into a judgment until almost two years after the loan transaction had been concluded, was neither expressly nor impliedly pro-

[4] We do not concede that the loan would have been invalid even if the Corporation had knowledge of petitioner's claim and had deliberately sought to ignore it. That question, however, is not presented in the instant case.

[5] At the time of the loan transaction, petitioner's claim had not yet been reduced to judgment and its only measure available would have been the "ad damnum" of $100,000 (R. 32).

vided for in the loan agreement. They further found that the failure to provide for this claim was deliberate and that it was not due to inadvertence, mistake or error. Consequently, no basis exists for a third party beneficiary suit."

Whatever arrangements were made with the Essex Trust Company are not here subject to revision inasmuch as the Trust Company is no longer a party to this action. The precise transaction which petitioner seeks to have reformed is the application for a loan on the part of the Bank and the loan itself accompanied by the pledge of the Bank's assets. In this particular transaction, there was no undertaking to pay any creditors. It would be an extraordinary interpretation to be placed upon the intention of the parties that the Corporation intended to assume liability to pay petitioner's claim while the liability of every other creditor of the Bank was assumed by the Trust Company. We submit that the court below correctly concluded that there was no intent on the part of the Corporation to assume liability for the payment of petitioner's claim.

" *Forbes* v. *Thorpe*, 209 Mass. 570, relied upon by petitioner (Pet. 10) does not support its argument. That case does not draw any parallel between willful misrepresentation and misconception or mistake. The *ratio decidendi* of the Massachusetts court was that the contract there specifically and very plainly provided for payment of the plaintiff's claim (*id.*, p. 580). In the instant case, the courts have found that the contract between the Bank and the Corporation not only did not so provide but on the contrary, deliberately, and in good faith, omitted to do so (R. 34–35, 61).

2. There is no federal public policy requiring the Federal Deposit Insurance Corporation to make whole all creditors of an insolvent bank or a solvent bank whose business is being liquidated. The power of the Corporation to enter into a loan agreement of the character here involved is conferred by Section 12B (n) (4) of the Federal Reserve Act, *supra*, p. 3. That Act authorizes the Corporation to make loans to an insured bank whenever such action will reduce the risk or avert a threatened loss to the Corporation; to make loans secured in whole or in part by assets of an open or closed insured bank, "which loans may be in subordination to the rights of depositors and other creditors." Any insured national bank is authorized to pledge its assets to secure such loans. There can be no question in the instant case that both the Bank and the Corporation had statutory authority to enter into the loan agreement, although neither was required by law to do so. It was purely a matter of discretion.

It is equally clear that discretion was vested in the board of directors of the Corporation to determine whether the loan was to be subordinated to the rights of depositors and other creditors. As the court below observed (R. 60), this subordination provision is not mandatory. The entire scheme

of federal bank deposit insurance embraces the insurance of deposit liabilities only. Section 12B of the Federal Reserve Act, as amended (12 U. S. C. 264); Cf. *Weir* v. *United States,* 92 F. (2d) 634 (C. C. A. 7), certiorari denied, 302 U. S. 761. The discretionary powers vested in the Corporation under the statutory loan provision are wider in scope than the power to insure deposits. This necessarily is essential in order that the purposes of the Act to insure deposits may be achieved. The Corporation is not limited when making loans to cases of insolvent banks, and the loans may be made "upon such terms and conditions as it [the Corporation] may determine" (see p. 3, *supra*). Inasmuch as the Corporation concerns itself with the insurance of deposits only, a contention that it is required by law to provide for the payment of nondeposit creditors such as petitioner is unfounded. There is nothing to indicate that the Corporation was under any statutory duty whatsoever to petitioner, and the court below so found (R. 63). Accordingly, the contract, which did not provide for subordination of the claims of the Corporation to those of creditors but on the contrary provided for securing the indebtedness to the Corporation, thereby indicating a clear intention not to subordinate the Corporation's claim, conformed in all respects with the provision of the statute. The contract did not in any manner violate the rights of petitioner as a creditor, and in the circumstances we submit that it is in no position

to urge that it was prejudiced by the Corporation's action.[7]

3. The question presented in the instant case is narrow and of no general importance. Admittedly, the Corporation had power to make the loan to the Bank and the Bank had power to pledge its assets to secure that loan (Section 12 B (n) (4) of the Federal Reserve Act, *supra*, p. 3). At the time the loan was made, so far as the record discloses, the Bank was solvent. No receiver has been appointed by the Comptroller of the Currency, and no question of a ratable distribution of the assets of an insolvent bank is involved. The pledge of assets by the Bank and transfer of its deposit accounts and of its liquid assets to the Essex Trust Company were found by the courts

[7] The suggestion (Pet. 3, 6, 12–13) that petitioner will be deprived of its right to a ratable distribution of the Bank's assets has no merit. The record discloses that the Bank is now in voluntary liquidation and its administration is in the hands of liquidating agents (see 12 U. S. C., secs. 181–186). The Federal Deposit Insurance Corporation has no part in the statutory liquidation of the Bank except to the extent that it is liquidating the collateral as pledgee of assets under the loan agreement. No receiver has been appointed. Consequently, the provisions of the National Bank Act of 1864 (12 U. S. C., sec. 194) governing ratable distribution by the Comptroller of the Currency are not before the Court (cf. Pet. 13). Moreover, the Act (12 U. S. C., secs. 181–186) makes no provision for ratable distribution on claims against a bank in voluntary, as dis-

to have been made in good faith for a fair consideration. The only question which possibly can be presented by this record is whether, under the loan agreement between the Bank and the Corporation, the latter undertook to pay petitioner's claim. Concededly, the Corporation did not directly undertake to pay any claim, either of a depositor or of any other creditor. Thus, the sole question decided by the court below was whether the manner in which the Bank and the Corporation entered into the loan agreement, taken in conjunction with ancillary happenings, was sufficient to charge the Corporation with the payment of petitioner's claim. The court below did not fail to follow any applicable federal decision nor did it purport to apply state law in preference to

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tinguished from involuntary, liquidation. *Houston* v. *Drake*, 18 F. Supp. 693 (D. Ariz.), reversed on other grounds, 97 F. (2d) 863 (C. C. A. 9). Whether petitioner will receive its just share is a question which concerns the liquidating agents of the Bank, not the Federal Deposit Insurance Corporation. Since, however, only a solvent bank may go into voluntary liquidation (*City N. B. of Huron* v. *Fuller*, 52 F. (2d) 870 (C. C. A. 8); *Houston* v. *Drake*, *supra*) and since the record discloses that petitioner concedes that the Bank is solvent, there is nothing in the record to show that petitioner will not receive its pro rata share when the liquidating agents conclude their administration. There is evidence that the Bank's equity in the collateral security is substantial (R. 36, 58), and petitioner's rights against the liquidating agents have been specifically preserved (R. 36, 66). Cf. *Pickett* v. *Trixler*, 93 F. (2d) 178, 182 (C. C. A. 7), certiorari denied, 303 U. S. 652.

federal law. The case turns on its own peculiar facts, and insofar as we are aware, no other claim either has arisen or is now pending in respect of a loan made by the Federal Deposit Insurance Corporation which bears any resemblance to the facts in the instant claim.

CONCLUSION

We respectfully submit that the decision of the court below was correct and that its decision involves no federal question of substance or general importance. The petition for a writ of certiorari should therefore be denied.

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AUGUST 1943.

U. S. GOVERNMENT PRINTING OFFICE: 1943